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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1957

No. 379

In the Matter of the Application
*of*
EARL J. CARROLL, Petitioner,
v.
UNITED STATES, Respondent.

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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*v.*

UNITED STATES,

Respondent.

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered in the above entitled proceeding on July 8, 1957.

### Citations to Opinions Below

The opinion of the District Court (R. 97a-102a) (printed in the Appendix hereto, *infra*, p. 21), is reported in 145 F. Supp. 634. The opinion of the Court of Appeals (R. 109a-115a), printed in the Appendix hereto, *infra*, p. 27, is as yet unreported.

## Jurisdiction

The judgment of the Court of Appeals was entered on July 8, 1957 (R. 116a; p. 35, *infra*). The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

## Question Presented

Considering the statutory mandate that income earned by a "bona fide resident of a foreign country" from sources without the United States "*shall not be included in gross income and shall be exempt from taxation*" (Section 116, I.R.C. 1939), and the provisions of the Code limiting examinations to what is "required to be included in the return" (Section 3614, I.R.C. (1939), and what is "relevant or material" (Section 7602, I.R.C. 1954), and protecting a taxpayer against an "unnecessary examination" (Section 7605(b), I.R.C. 1954), when an individual has appeared at administrative hearings and established conclusively that he is a bona fide resident of a foreign country may the Internal Revenue Service merely upon alleging its belief that he was not a bona fide foreign resident—without showing any reasonable grounds therefor—invoke the authority of the Courts to compel the individual to reveal the amount of such non-reportable, non-taxable foreign earned income?

## Constitutional Provision and Statutes Involved

The Constitutional provision involved is Amendment IV. The statutes involved are: Section 116(a) (1, 3), Sections 54(a) and 3614(a) of the Internal Revenue Code of 1939; and Sections 7602, 7603 and 7605(b) of the Internal Revenue Code of 1954.

The constitutional provision and statutory sections provide as follows:

## Constitution of the United States

### Amendment IV—Searches and Seizures

The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated and no Warrants shall issue, but upon probable cause, supported by Oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized.

## Internal Revenue Code—1939

### § 116—Exclusions from Gross Income

In addition to the items specified in section 22(b) the following items shall not be included in gross income and shall be exempt from taxation under this chapter:

(a) Earned income from sources without the United States.

(1) Foreign resident for entire taxable year. In the case of an individual citizen of the United States, who establishes to the satisfaction of the Commissioner that he is a bona fide resident of a foreign country or countries during the entire taxable year, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) if such amounts constitute earned income (as defined in paragraph (3)); * * *

* * *

(3) Definition of earned income. For the purposes of this subsection, "earned income" means wages, salaries, professional fees and other amounts received as compensation for personal services actually rendered * * *

(Section 911, I.R.C. 1954, provides for the same exemption except that it provides for a greater period of exemption since taxpayer need no longer have been a foreign resident for "the entire taxable year." Under the 1954 Code taxpayer is exempt from reporting and paying tax on foreign earned income if he has been a bona fide resident of a foreign country "for an uninterrupted period which includes an entire taxable year.")

**§ 54—Records and Special Returns**

(a) By taxpayer. Every person liable to any tax imposed by this chapter or for the collection thereof, shall keep such records, render under oath such statements, make such returns, and comply with such rules and regulations, as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

**§ 3614—Examination of Books and Witnesses**

(a) To determine liability of taxpayer. The Commissioner, for the purpose of ascertaining the correctness of any return or for the purpose of making a return where none has been made, is authorized, by any officer or employee of the Bureau of Internal Revenue, including the field service, designated by him for that purpose, to examine any books, papers, records, or memoranda bearing upon the matters required, to be included in the return, and may require the attendance of the person rendering the return or of any officer or employee of such person, or the attendance of any other person having knowledge in the premises, and may take his testimony with reference to the matter required by law to be included in such return, with power to administer oaths to such person or persons."

**Internal Revenue Code—1954**

**§ 7602—Examination of Books and Witnesses**

For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary or his delegate is authorized—

(1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;

(2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary or his delegate may deem proper, to appear before the Secretary or his delegate at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inqury; and

(3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry.

**§ 7603—Service of Summons**

• • • When the summons requires the production of books, papers, records, or other data, it shall be sufficient if such books, papers, records, or other data are described with reasonable certainty.

§ 7605—Time and Place of Examination

* * * * *

(b) Restrictions on examination of taxpayer.—No taxpayer shall be subjected to unnecessary examination or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary or his delegate, after investigation, notifies the taxpayer in writing that an additional inspection is necessary.

## Statement

This case concerns the authority of the Internal Revenue Service to conduct a general investigation of a non-resident's earned income received from sources without the United States when, by statute, that income is *exempt* from taxation, and the individual need not file a tax return or keep records pertaining to such income.

Petitioner has been a bona fide resident of Germany from November, 1946, when he went there for an indefinite period to engage in the civilian practice of law (R. 69a). Prior thereto Petitioner, as a United States army officer, was assigned to duty in Germany. He continued to reside in Germany until March, 1955, except for the period beginning in January, 1948, when his German entry permit was revoked and he was refused a re-entry permit until March, 1949 (R. 32a-33a). Petitioner maintained a law office and his residence in Germany for nine years until March, 1955 when he moved to Switzerland, his present place of residence (R. 69a). On a visit to the United States in December, 1955 he was subpoenaed to appear before an officer of the Internal Revenue Service. He appeared and gave testimony at two hearings—on August 16 and 27, 1956 (R. 54a). He answered fully all questions asked of him except those relating to "contrac-

tual and financial terms'' and ''income earned'' in Germany during the period of his bona fide residence in Germany (R. 6a). Petitioner's position was that since he had fully testified and conclusively demonstrated that he was a bona fide resident of a foreign country and since there had been absolutely no testimony or evidence adduced at these hearings to contradict this showing, any further inquiry into the details and amounts of income which was exempt from taxation and exempt from being included in a return would be an unreasonable search and an oppressive and unnecessary investigation (R. 29a-30a). Throughout all these years Petitioner filed United States tax returns covering income received from sources within the United States which by statute was not exempt from taxation. No element of fraud or deceit is involved in this case.

In order to compel petitioner to testify relative to his foreign earned income and to produce his records regarding the amounts of such tax exempt income, the Internal Revenue Service obtained, *ex parte*, an order (R. 2a) requiring Petitioner to appear and give testimony relating to the contractual and financial arrangements he had with two clients, Frederick Flick and Alfred Krupp von Bohlen during the years in question and to, ''produce all books, records, cancelled checks, memoranda and papers of whatsoever kind or nature pertaining to income or monies received, accrued or credited to his account during the years 1944 to 1954 inclusive . . .''.

Petitioner moved to vacate and quash the *ex parte* order. The District Court for the Southern District of New York denied this motion. The District Court ruled that the government need not make any showing of the necessity or statutory authority for the investigation and that it was sufficient if the moving papers merely allege that the revenue agents, ''have reasonable grounds to believe and do believe that respondent was not a bona fide resident of a foreign country'' (R. 100a).

On appeal to the Court of Appeals for the Second Circuit the decision of the District Court was affirmed. In an opinion by Judge Medina it was recognized that there is an "apparent conflict between the cases dealing with what the tax authorities must show to warrant examination of the taxpayer and others relative to matters which may be barred by the statute of limitations." But the Court held, "that in such situations as the one before us now the Internal Revenue Service need not introduce evidence on the residence issue as a prerequisite to investigation" (R. 115a).

## Reasons for Granting the Writ

### I

The present case involves the important question of conflict between the power of an administrative agency to interrogate and examine without limitation and the individual's right, protected by the Fourth Amendment, to be secure in his person and papers and to avoid an unnecessary and oppressive investigation into private affairs. The decision of the Court of Appeals for the Second Circuit in this case is in conflict with *Hale* v. *Henkel*, 201 U. S. 43, 76, and *Federal Trade Commission* v. *American Tobacco Company*, 264 U. S. 298, 306, both of which cases struck down inquiries and onerous subpoenas not justified by the ends sought.

Petitioner demonstrated by facts, not controverted, that he is a "bona fide resident of a foreign country" and his earned income from foreign sources is exempt from taxation and is not reportable. Among other things, he showed that he resided and was physically present in Germany from November, 1946 to March, 1955 except for the period of January, 1948 to March, 1949 when his German entry permit was revoked and except for three short trips he made to the United States—in 1952 for seven days; in 1953 for about four days; and in 1954 for ten days (R. 35a).

In addition to the exemption granted to a bona fide resident of a foreign country, Petitioner was automatically entitled to a complete exemption from taxation for the years 1951 and 1952 under the eighteen months rule since such exemption was granted on the basis of mere physical presence outside the United States for 510 days in an 18 month period (Section 116, I.R.C. 1939, as amended by the Revenue Act of 1951). It cannot be seriously questioned that Petitioner was not only physically outside the United States during the years in question but that he was then and still is a bona fide resident of a foreign country.

Under the regulations and rulings of the Internal Revenue Service, Petitioner is presumed to be a foreign resident "in the absence of known facts" to the contrary where he has resided in a foreign country for as much as a year (O.D. 197, 1 Cum. Bul. 164, as made applicable to the issue of foreign residence by Reg. § 1.911-1 and Reg. § 1.871-2). In view of the fact that Petitioner has resided in Germany for nine years there can be no reasonable doubt but that he was and still is a bona fide foreign resident. (See, *Weible* v. *United States*, 244 F. 2d 158 (9th Cir.); *Larsen* v. *Commissioner*, 23 T. C. 599; *Meek* v. *United States*, 110 F. Supp. 658 (N. D. Col. S. D.); *Seeley* v. *Commissioner*, 186 F. 2d 541 (2nd Cir.); *Walker* v. *Commissioner*, 16 T.C.M. 171).

This is not the ordinary case in which Petitioner denied tax liability and sought to avoid an examination. Here Petitioner responded to an administrative subpoena and testified at two separate hearings; he objected to any examination as to private matters involving income from foreign sources on the grounds that under statutory mandates such income of a bona fide foreign resident was not reportable or taxable (Sec. 116(a), I.R.C. 1939, now Sec. 911, I.R.C. 1954) and that he had clearly demonstrated that he was such a bona fide foreign resident. Also that, in addition, he fell within the eighteen month rule during the years it was in effect.

Petitioner has a constitutional right to have his personal financial affairs protected from any oppressive and unwarranted inquiry and the requested examination involving an area in which he has demonstrated a freedom from any obligation to report or pay taxes is arbitrary and oppressive. As was stated by the Ninth Circuit in *Local 174 v. United States*, 240 F. 2d 387, 390 (9th Cir.), "* * * such a proceeding [to compel testimony and the production of records] is in the nature of a search and seizure which has constitutional overtones * * *." It need hardly be argued that no right is entitled to greater constitutional protection than the right of a citizen to privacy. An invasion of this right of privacy by the Government's subjection of a citizen to an unnecessary and unauthorized examination is an unreasonable search condemned by the Fourth Amendment.

> "It has always been recognized in this country, and it is well to remember, that few, if any, of the rights of the people guarded by fundamental law are of greater importance to their happiness and safety than the right to be exempt from all unauthorized, arbitrary or unreasonable inquiries and disclosures in respect of their personal and private affairs . . ." (*Sinclair v. United States*, 279 U. S. 263, 292).

The law does not authorize Internal Revenue Agents to examine everyone and anyone about any and all subjects, nor does it permit them to examine any and all books and records. The powers are very limited (Section 3614 Internal Revenue Code 1939, now Section 7602 Internal Revenue Code 1954). They are limited to examination "bearing upon matters required to be included in the return". If, as in this case, the information sought is not matter required to be included in a return but involves foreign income which the law says is neither reportable or taxable, then the Internal Revenue Agents lack the power to elicit the information, and the *ex parte* order dated

August 22, 1956, should have been vacated. The language of the statute authorizing examinations was changed slightly in the 1954 Internal Revenue Code, which was passed after the events here involved took place, but at the Congressional hearings it was stated that the meaning of the 1954 enactment was the same as it was under the 1939 code.

Petitioner has been ordered to "* * * produce all books, records, cancelled checks, memoranda and papers of whatsoever kind or nature pertaining to income or monies received, accrued or credited to his account during the years 1944 to 1954 inclusive * * *" (R. 2a). Petitioner has testified that any records he may have, although he was not required to keep any, were at his office in Frankfurt, Germany. To require him to travel about 6,000 miles and gather records for a ten-year period in order to bare for the benefit of the Internal Revenue Service his entire financial life for this period, when he has established that he is exempt from taxation, is an unconstitutional infringement of his individual rights. There can be no justification for requiring the production by an individual, against whom there is no basis for any tax liability, of such a mass of documents with the only specificity being that they cover a ten-year period.

The approach of the Government in requiring an en masse production of documents without specificity has been criticized by the Courts even where it appears that some of the documents may be relevant (*Hale* v. *Henkel, supra,* at p. 77—". . . Doubtless many, if not all, of these documents may ultimately be required, but some necessity should be shown, either from an examination of the witnesses orally, or from the known transactions of these companies with the other companies implicated, or some evidence of their materiality produced, to justify an order for the production of such a mass of papers. A general subpoena of this description is equally indefensible as

a search warrant would be if couched in similar terms . . ."; *Federal Trade Commission* v. *American Tobacco Company,* 264 U. S. 298, 306); *Oklahoma Press Publishing Company* v. *Walling,* 327 U. S. 186, 208-210; *Schwimmer* v. *United States,* 232 F. 2d 855 (8th Cir.), cert. den. 352 U. S. 833.

## II

The decision of the Court of Appeals in the present case is in direct conflict with the following decisions of the Third and Ninth Circuits—*Martin* v. *Chandis Securities Co.,* 128 F. 2d 731 (9th Cir.); *Local 174* v. *United States, supra; Boren* v. *Tucker,* 239 F. 2d 747, 773 (9th Cir.); *Zimmerman* v. *Wilson,* 105 F. 2d 583 (3rd Cir.).

(a) These cases hold that an inquiry cannot be had for a period barred by the statute of limitations or in cases where there is a mere allegation of fraud without any factual showing. In the present case a mere "belief" by the Internal Revenue agent as to petitioner's residence cannot suffice in the light of the overwhelming factual showing made by petitioner as to his bona fide foreign residence. It is submitted that the present situation, involving a statutory mandate making foreign earned income of a non-resident citizen neither reportable nor taxable, presents an even more compelling case for relief than the "statute of limitation" cases. There is nothing *"sui generis"* about the statute of limitation cases. Certainly the principle which governs such cases is equally applicable here.

In the present case the *ex parte* order requiring Petitioner to testify and produce records was obtained upon an affidavit of Mr. Bernard V. Roberts (R. 5a), which fails to allege even on belief that Petitioner was not a bona fide foreign resident. When Petitioner moved to vacate and

quash said *ex parte* order, for the first time Mr. Roberts alleged in an opposing affidavit his "'belief,'' without more, that Mr. Carroll was not a bona fide resident of a foreign country (R. 88a). No factual showing or reason for such "belief'' was made by the Government. Petitioner's motion was denied solely on the statement of "belief'' contained in Mr. Roberts' affidavit.

(b) The Court of Appeals in the present case has stated that there is a conflict among the Circuits with regard to the nature of the showing that must be made by the Government to justify an investigation of a taxpayer as to a tax year barred by the statute of limitations. The Court said: "We are not now called upon to resolve the apparent conflict between the cases dealing with what the tax authorities must show to warrant examination of the taxpayer and others relative to matters which may be barred by the statute of limitations'' (R. 115a).

A reading of the opinions in the cases cited by the Court of Appeals in support of its conclusion reveals that the cases it cites are not in conflict with the Third and Ninth Circuit rulings and that the present case is the only one which conflicts with the settled rule that a showing of the reasonableness and necessity for the examination must be made by the Government.

*Peoples Deposit Bank & Trust Co.* v. *United States,* 212 F. 2d 86 (6th Cir.), cert. den. 348 U. S. 838, and *In re Wood,* 123 F. Supp. 297, 130 F. Supp. 121 (W. D. Ky.), relied upon by the Court below, involved the well-known net-worth-expenditures method of determining liability in which it was necessary to reconstruct the financial history of taxpayer in prior years. In reconstructing this history the records sought by the Government were records of income and were the only records from which the Government could determine the question of fraud. Moreover, in the *People's Deposit* and *Wood* cases, where the Govern-

ment sought to examine the only records which provided the ultimate proof of fraud, the District Court held hearings and required the Special Agents to give testimony to show reasonable grounds and necessity for the investigations.

In *Norda Essential Oil and Chemical Co.* v. *United States*, 230 F. 2d 764 (2nd Cir.), cert. den. 351 U. S. 964, and *Falsone* v. *United States*, 205 F. 2d 734 (5th Cir.), also relied upon by the Court below, the Government was investigating years not barred by the statute of limitations, to which the records of a closed year were found to be relevant because of the net-worth-expenditures method of reconstructing income. It was conceded in those cases that an open year existed and therefore there was no need for the Government to make a showing that a tax year existed which was open to assessment. *Globe Construction Co.* v. *Humphrey*, 229 F. 2d 148 (5th Cir.) affirmed an unreported District Court case and held that the particular affidavit was sufficient. The contents of this affidavit are not reported and we cannot determine from this case the extent of the Government's showing of relevance and necessity. In *United States* v. *United Distillers Products Corp.*, 156 F. 2d 872 (2nd Cir.), no defense based upon the statute of limitations was made in the District Court. On appeal the defense of the statute of limitations was raised for the first time and rejected, not because the Government did not have to make a showing of possible fraud but because, irrespective of fraud, the tax years involved were not barred if the taxpayer had omitted from gross income a sum exceeding 25% of the amount reported. It was necessary for the Government to examine taxpayers records to determine if this percentage had been exceeded. Finally, *Matter of Levine*, 149 F. Supp. 642, aff'd 243 F. 2d 175 (2nd Cir.) involved a taxpayer, charged with liability for withholding taxes, whom the Government sought to examine regarding open

tax years. There was no possible grounds for denying the investigation into years which were admittedly open to assessment. In the *Levine* case the Court recognized that a different rule would apply if it appeared that no assessment could be made. The Court said: "Nor does he invoke any question of the Statute of Limitations. Thus he has presented no reason for denying the Treasury Department its statutory right to examine him to see if taxes have been properly paid" (149 F. Supp. 642, 643).

(c) The Court of Appeals has also relied upon the decisions of this Court in *Oklahoma Press Publishing Co.* v. *Walling*, 327 U. S. 186, and *Endicott Johnson Corp.* v. *Perkins*, 317 U. S. 501, saying: "Although those cases arose in different context, we think them applicable here". However, we believe that the *Oklahoma Press* and *Endicott Johnson* cases decided by this Court do not govern the present one since (1) they involve statutes, other than the Internal Revenue Code, in which the administrative investigatory power is not subject to the explicit restraints of the Internal Revenue Code, and (2) they do not involve a situation where a party at an administrative hearing demonstrated that any further inquiry would be oppressive, unnecessary and an unreasonable search in violation of the Fourth Amendment.

*Endicott Johnson Corp.* v. *Perkins*, 317 U. S. 501, involved the Walsh Healy Public Contracts Act, 49 Stat. 2036, chap. 881 41 U.S.C. §§ 35-45. Section 5 of this Act (41 U.S.C. § 39) gives the Secretary of Labor the authority to:

> "* * * make findings of fact after notice and hearing, which findings shall be conclusive upon all agencies of the United States, and if supported by the preponderance of the evidence, shall be conclusive in any court of the United States."

The Secretary of Labor subpoenaed certain records of the Company and the District Court refused to enforce the subpoena because of its finding that the Company was not covered by the Act. The Supreme Court upheld the subpoena. Mr. Justice Jackson indicated that the District Court could not make an initial determination of coverage because the Walsh Healy Act gave the Secretary of Labor, and no one else, the power to conclusively determine the facts. He said, at 317 U. S. 509:

> "The consequence of the action of the District Court was to disable the Secretary from rendering a complete decision on the alleged violation as Congress had directed her to do, and that decision was stated by the Act to be conclusive as to matters of fact for purposes of the award of government contracts".

The *Endicott Johnson* decision was followed in *Oklahoma Press Pub. Co.* v. *Walling, supra,* a case which involved the administrative subpoena power under the Fair Labor Standards Act, 52 Stat. 1060, chap. 676, 29 U.S.C. § 211(a). Again this Court decided that the statute gave the Administrator and not the District Court the authority to determine coverage. Mr. Justice Rutledge said:

> "We think, therefore, that the Court of Appeals were correct in the view that Congress has authorized the Administrator, rather than the District Courts in the first instance to determine the question of coverage in the preliminary investigation of possibly existing violations; in doing so to exercise his subpoena power for securing evidence upon *that* question, by seeking the production of petitioner's relevant books, records and papers; and, in case of refusal to obey his subpoena, issued according to the statutes' authorization, to have the aid of the District Court in enforcing it" (327 U. S. 186, 214) (Emphasis supplied).

In comparison to the Walsh Healy Act and the Fair Labor Standards Act the Internal Revenue Code strictly limits the investigatory power of the Internal Revenue Service and it is for the Courts and not the administrative agency to ultimately determine the facts. *Meals* v. *United States*, 110 F. Supp. 658. Under the Internal Revenue Code an examination can only involve records, which bear upon matters "required to be included in the return" (Section 3614, I.R.C. 1939) and "which may be relevant or material to such inquiry" (Section 7602, I.R.C. 1954). In addition, unlike the statutes involved in *Endicott Johnson* and *Oklahoma Press*, the Internal Revenue Code explicitly states:

> "No taxpayer shall be subject to unnecessary examination or investigation" (Section 7605(b), I.R.C., 1954).

Furthermore, the *Endicott* and *Walling* cases involved statutes which gave the administrative agencies the exclusive authority to determine coverage, but it has repeatedly been held that under the Internal Revenue Code the Courts are the final arbiters on this issue. This is so even though Section 911(a), I.R.C. 1954, requires an individual to establish to the satisfaction of the Secretary or his delegate that he has been a bona fide resident of a foreign country. The Courts' decisions are not limited to the question of whether the Secretary has abused his discretion in not being satisfied. The Tax Court as well as the District Courts are authorized as a matter of law to examine the facts *de novo* and are not bound by the findings of the Secretary. See, *Hamer* v. *Commissioner*, 22 T. C. 343, 349; *Walker* v. *Commission*, *supra*; *Meals* v. *United States*, *supra*.

(d) In the present case Petitioner has appeared at two administrative hearings and has fully answered all questions relative to his foreign residence. Considering his

showing of bona fide residence and considering the unusual burden the Government seeks to impose upon Petitioner by requiring him to transport from Germany his records over a ten-year period and considering the language of the Internal Revenue Code itself, the *Endicott Johnson* and *Oklahoma Press* cases are not controlling of the present situation. These cases did not involve the question of whether the scope of the investigation constituted an unreasonable search in violation of the Fourth Amendment and this Court has recognized that there may be a distinction when a case of that sort should arise:

> ". . . the requirement of reasonableness, including particularity in 'describing the place to be searched, and the persons or things to be seized,' also literally applicable to warrants, comes down to specification of the documents to be produced, adequate, but not excessive, for the purposes of the relevant inquiry." (*Oklahoma Press Pub. Co.* v. *Walling*, 327 U. S. 186, 209.)

After petitioner had conclusively demonstrated he was a bona fide resident of a foreign country it was the Government's burden to show that the documents summoned were "adequate, but not excessive," for the purposes of the investigation. The mere statement that the Government believes Petitioner not to be a foreign resident is insufficient to deprive Petitioner of the constitutional and statutory protections which are guaranteed to him.

(e) The Court of Appeals after stating that the "kind of legal work which petitioner did during these years, for whom, how much and on what basis he was paid, how he was paid and when, they all seem to bear largely on the amount of his income," continued to state, "it cannot be said that such information regarding the activities of a professional man are irrelevant to the question of his residence" (R. 115a). Respectfully it is submitted that

the latter expression by the Court of Appeals sidetracks the issue. First, the Government makes no pretense of seeking such information on the question of residence. Second, what rational relationship can there be between the details and amounts of income received from foreign sources and the independent substantive question of Petitioner's foreign residence? The reasonableness of and necessity for the investigation must first be shown before the inquiry may proceed.

> ". . . It is contrary to the first principles of justice to allow a search through all the respondent's records, relevant or irrelevant, in the hope that something will turn up." *Federal Trade Commission* v. *American Tobacco Company*, 264 U. S. 298, 306 (1924).

(f) Congress in its wisdom has seen fit to place the authority to compel the attendance of a witness and the production of books and records in the Federal Courts. (Section 7604(a), I.R.C. 1954). When the Government seeks to utilize the judicial machinery for making its investigation it cannot refuse, as it has in the present case, to show that there are reasonable grounds for conducting the investigation.

> ". . . By thus making the federal judiciary the affirmative agency for enforcing the authority . . . Congress necessarily brings into play the specific provisions of the Constitution relating to the prosecution of offenses and those implied restrictions under which courts function." (*Watkins* v. *United States*, U. S. Sup. Ct. (June 17, 1957) 1 L. Ed. 2d 1273, 1300.)

Petitioner is entitled to the protection of a statutory mandate, under which income from foreign sources earned by a bona fide foreign resident is not reportable to the United States Internal Revenue Service and is not taxable. We urge upon this Court the view expressed by the

District Court in *In re Brooklyn Pawnbrokers, Inc.*, 39 F. Supp. 304, 305, a case dealing with an attempted inquiry into tax matters involving a year barred by the statute of limitations, that the Court should assure a citizen, "that freedom from unreasonable harassment that he has the right to expect under a democratic form of government."

The present case is in conflict with the decisions of this Court and with the decisions of Courts in two other Circuits as hereinabove indicated and it also deprives petitioner of the constitutional protection to which he is entitled, from an arbitrary and oppressive inquiry into his private affairs.

## CONCLUSION

**For the foregoing reasons, the petition for a Writ of Certiorari should be granted.**

Respectfully submitted,

JOHN P. MCGRATH,
Counsel for Earl J. Carroll,
Petitioner.

August 15, 1957.

# APPENDIX

## Opinion of the United States District Court

(116) EDELSTEIN, D. J.:

This is a motion to vacate an ex parte order directing respondent, in effect, to obey an Internal Revenue Service summons that had been previously served on him. Section 7601 of the Internal Revenue Code of 1954 authorizes the Secretary of the Treasury or his delegate to inquire after all persons who may be liable to pay an internal revenue tax, and Section 7602 provides for the examination of books and records and the taking of testimony which may be relevant or material to such inquiry. The analogous section of the 1939 Code, Section 3614, provided for the examination of books and the taking of testimony "bearing upon the matters required to be included in the return", but the phrasing of Section 7602 of the 1954 Code, in terms of data and (117) testimony which "may be relevant or material" to the inquiry constitutes no material change from the prior law. Senate Committee Report No. 1622, p. 617, Section 7605(b) requires that no taxpayer shall be subjected to unnecessary examination or investigations. The examination of the respondent, who claims to have been, in the years under investigation, a bona fide resident of Germany whose income derived from the practice of international law, is directed not only to his general liability for taxes but also to the specific amounts payable. Respondent refused to answer questions or furnish data that he considers to bear upon the amount of tax payable, consenting only to submit to examination on his status as a bona fide resident of Germany. Any other examination, he contends, is unnecessary and not relevant or material to the inquiry, or "bearing upon the matters required to be included in the return", because under Section 116 of the 1939 Code, his income for the years in

question was not reportable or taxable, being earned income of a bona fide foreign resident.

The pleadings which frame the issue for decision are the application for enforcement of the summons, consisting of two affidavits, the motion to vacate the ex parte order and the affidavit in opposition. The (118) application for the ex parte order is treated as a complaint, and under Rule 8(a) of the Federal Rules of Civil Procedure it is necessary for the complaint to contain "a short and plain statement of the claim showing that the pleader is entitled to relief." *Martin* v. *Chandis Securities Co.* (9 Cir.) 128 F. 2d 731. From the "complaint" it appears that the respondent was subpoenaed to appear before an officer of the Internal Revenue Service; that he declined to answer certain questions relating to the contractual and financial terms between himself and certain persons during the years 1944 and 1954; that he declined to furnish any information concerning other income earned in Germany or other foreign countries during the years 1944 to 1954 inclusive; and that he failed to produce for examination the books, records and papers required by the subpoena. Without more, it is apparent from the face of the complaint that the information sought is relevant to the inquiry concerning persons who may be liable to pay an internal revenue tax, or that it bears upon matters required to be included in a return, and by the very nature of the information required it does not appear to be unnecessary. Thus, the complaint does not fail to state a claim for relief.

(119) Respondent attempts to raise the issues of relevance and necessity by the allegations of fact in his motion to vacate. He sets forth at length facts to indicate that, during the years in question, his income consisted of fees earned as an international lawyer while he was a

bona fide resident of Germany, thus qualifying him from exemption from the filing of a return and the payment of taxes under Section 116 of the 1939 Code. If he is not required to file a return for those years, an inquiry into the details of his income cannot be relevant or necessary. Therefore, he argues, the only inquiry presently proper is on the issue of his foreign residence.

Apparently he demands some sort of a threshold determination of the issue, but it is not at all clear how such a determination is to be achieved. The contention that the Internal Revenue Service is required to permit him to establish his bona fide foreign residence at the inquiry is without merit. The inquiry is strictly inquisitorial and not a judicial proceeding where rights are finally determined. *In re Albert Lindley Lee Memorial Hospital* (2 Cir.), 209 F. 2d 122; *Matter of Sidney S. Levine*, 1956 P-H Fed. Tax Service, Par. 72,535 (S.D.N.Y., 1956, not officially reported), affirmed on the opinion of Judge Kaufman, 1956 P-H Fed. Tax (120) Service Par. 71,092 (2 Cir., 1956, not officially reported). The power vested in the Secretary is similar to the power vested in federal grand juries. *Falsone* v. *United States* (5 Cir.), 205 F. 2d 734. A grand jury is not required to hear and decide the defenses of a prospective defendant.

Nor does this court have the power at this time to decide the issue of foreign residence so as to determine the coverage of the defendant by the internal revenue laws. Cf. *Endicott Johnson Corp.* v. *Perkins*, 317 U. S. 501; *Okla. Press Pub. Co.* v. *Walling*, 327 U. S. 186. Congress has conferred upon the Secretary the power and duty to administer the internal revenue laws, including the law relating to the exemption from taxation of foreign residents, and it has provided a method of inquiry for effectuating that purpose. The eventnal decision of whether or not an assessment shall be made is one for the appro-

priate administrative authority, not for the court, to decide the issue of coverage now might preclude an inquiry by the administrative authority and disable it from carrying out its prescribed function. The issue of bona fide foreign residence may, in due course, reach the court in a suit for a refund, but the court may not short circuit the procedure by usurping the administrative function.

(121) The statute of limitations cases relied upon by the respondent are consistent with this conclusion. In *Martin* v. *Chandis Securities Co.* (9 Cir.) 128 F. 2d 731, the complaint indicated on its face that inquiry was sought into years for which the statute of limitations had run, and there was no allegation that the return was false or fraudulent so that limitation would not apply. The case is simply one where the complaint failed to state a claim for relief. It by no means stands for the proposition that the court must make an initial determination of coverage. On the contrary, where the statute of limitations is involved on the face of the complaint, an inquiry may be required upon merely a conclusory allegation of suspicion of a false and fraudulent tax return, without even the necessity of the proof of facts showing reasonable grounds to believe the return to be fraudulent. *United States* v. *United Distillers Products Corp.* (2 Cir.) 156 F. 2d 872; *In re Wood*, 123 F. Supp. 297, and 130 F. Supp. 121. In *Falsone* v. *United States* (5 Cir.) 205 F. 2d 734, it appeared that the statute of limitations had run against the returns for certain years, but an inquiry into those years was permitted on an allegation that it was necessary to a so-called net worth case involving more recent years. Thus, even if there appeared on the face of the application for the ex parte order, in (122) the case at bar, facts indicating that the respondent was a bona fide foreign resident during the years in question, an allegation that the Internal Revenue Service agents have reasonable grounds to believe and do believe that the respondent was not a bona

fide resident of a foreign country during those years, within the meaning of the Internal Revenue Code, would suffice to sustain the order. Inasmuch as the facts are alleged in the motion to vacate, the allegation of belief set forth in the affidavit in opposition suffices, and no further showing is required.

Other cases cited by the respondent are merely those where the showing made by the Government clearly indicated a lack of relevance or necessity. The burden of establishing that the information sought was actually needed and necessary was not met where the examination was for the purpose of aiding the Government in defense of a lawsuit, in lieu of an examination before trial, *Pacific Mills* v. *Kenefick* (1 Cir.) 99 F. 2d 188; or for the purpose of procuring evidence that might be material in verification of the tax return of some other person than the one examined, not known to the Bureau of Internal Revenue, and who may or may not have made a return, *McDonough* v. *Lambert* (1 Cir.), 94 F. 2d 839; *Mays* v. *Davis*, 7 F. Supp. 596; *In re International Corporation*, 5 F. Supp. 608. But where, as here, the (123) Internal Revenue Service agents state that they have made an investigation, that they have reasons to believe taxes are owing, and that the data sought are necessary to the completion of their inquiry, the burden of showing necessity is met.

The Government has no burden of showing probable cause to justify its inquiry by summons. Only where a third party is requested to produce records relating to a taxpayer under investigation is there a requirement for the Government to establish that the benefit it will derive from the data sought bears a reasonable relation to the burden placed on the respondent. *First Nat. Bank of Mobile* v. *United States* (5 Cir.) 160 F. 2d 532; *United States* v. *Third Northwestern Nat. Bank*, 102 F. Supp. 879; *Matter of Sidney S. Levine, supra.* A requirement of a prior showing or determination of tax liability would

defeat the purpose of Section 7601, which authorizes inquiry after persons "who may be liable to pay any internal revenue tax". A taxpayer may not refuse to disclose the details of his income because he believes that the income is not taxable, and thereby frustrate an inquiry by requiring proof to the contrary in advance.

In any event, it does not appear that the issue of general tax liability is insulated from the details of the respondent's income. Only earned income is (124) exempt under Section 116 of the 1939 Code, and the Government is entitled to inquire into the income source. If, as has been indicated, respondent received fees in property rather than in cash, any gain realized from that property would not be earned income, under the definition of Section 116. Furthermore, it appears that some part of the fees he received was for work done in the United States, and compensation for such work is taxable. Finally, the Government contends that the details of his income are necessary to decide the residence question on the ground that such items as the amount of taxes paid to the German Government and the ratio of military to non-military cases handled by respondent abroad are relevant to the issue. He denies the relevance of such information to the question of residence; but the determination of relevancy "is a burden and responsibility which the proposed witness should not assume." *Stone* v. *Frandle*, 89 F. Supp. 222, 224. "Obviously, the taxpayer cannot be the judge of what books and papers are relevant and material, and thus restrict the examination of his financial affairs to papers of his own selection. A determination of the matter, in the first instance at least, is for the Commissioner, who is charged with the duty of verifying (125) the correctness of the taxpayer's returns." *In re International Corporation Co.*, 5 F. Supp. 608, 611.

Accordingly, the motion to vacate will be denied.

Dated: January 2nd 1957.

DAVID N. EDELSTEIN,
United States District Judge.

*Appendix.*

## Opinion of the United States Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 362—October Term, 1956.

(Argued June 4, 1957 Decided July 8, 1957.)

Docket No. 24468

In the Matter of the Application of the

UNITED STATES,

*Appellee,*

for an Order compelling

EARL J. CARROLL,

*Appellant,*

to comply with an Internal Revenue Summons.

Before:

MEDINA, LUMBARD and WATERMAN,

*Circuit Judges.*

Appeal from an order of the United States District Court for the Southern District of New York, David N Edelstein, *Judge.*

Taxpayer appeals from an order denying his motion to vacate an *ex parte* order directing him to obey an Internal

Revenue summons that had been previously served on him. Reported below at 149 F. Supp. 634. Affirmed.

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PAUL W. WILLIAMS, United States Attorney for the Southern District of New York, New York City (Foster Bam and Miriam R. Goldman, Assistant United States Attorneys, New York City of Counsel), *for appellee.*

HODGES, REAVIS, MCGRATH & DOWNEY, New York City (John P. McGrath, Martin D. Jacobs and Martin H. Proyect, New York City, of Counsel), *for appellant.*

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MEDINA, *Circuit Judge:*

Appellant, an American citizen, lived and practiced law in Germany for most of the time from 1946 to 1954. During that period, he numbered among his clients Alfred Krupp von Bohlen and Halback, and Frederick Flick, the German industrialists. He may have earned a substantial amount of money from his practice, but he reported none, claiming to be within the exemption of Section 116 of the Internal Revenue Code of 1939 (substantially re-enacted I. R. C. 1954, Section 911), which applies to wages, salaries, professional fees and other amounts received as compensation for personal services actually rendered, earned without the United States by an American citizen who establishes to the satisfaction of the Secretary that he is a bona fide resident of a foreign country.

## *Appendix.*

### *Opinion of the United States Court of Appeals.*

Acting pursuant to authority conferred by law,[1] agents of the Internal Revenue Service summoned appellant to appear and give testimony relative to his residence and earnings in Germany. At hearings on August 16 and 17, 1956, appellant testified at length concerning his residence abroad. He refused, however, to answer questions relating to the following matters:

(a) The contractual and financial terms between Earl J. Carroll and Alfred Krupp von Bohlen and Halback during the years 194[illegible] through 1954.

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[1] The Internal Revenue Code of 1954 provides in pertinent part (omissions not indicated):

§ 7601. The Secretary or his delegate shall, to the extent he deems it practicable, cause officers or employees of the Treasury Department to proceed, from time to time, through each internal revenue district and inquire after and concerning all persons therein who may be liable to pay any internal revenue tax.

§ 7602. For the purpose of determining the liability of any person for any internal revenue tax, the Secretary or his delegate is authorized—

(1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;

(2) To summon the person liable for tax, or any other person the Secretary or his delegate may deem proper, to appear before the Secretary or his delegate and to produce such books, papers, records or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and

(3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry.

§ 7604. The United States district court for the district in which such person resides or is found shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, records, or other data.

(b) The contractual and financial terms between Earl J. Carroll and Frederick Flick during the years 1944 through 1954.

(c) Any and all information concerning other income earned in Germany or other foreign countries during the years 1944 to 1954, inclusive.

His refusal was based on the ground that he had conclusively demonstrated his bona fide residence in a foreign country, thus rendering investigation of his earnings there "unnecessary" within the meaning of I. R. C. 1954, Section 7605(b).[2]

The agents then sought and obtained from the District Court an *ex parte* order compelling appellant to testify in accordance with the summons that had been served upon him. Appellant thereupon moved the District Court to vacate the *ex parte* order, which motion was denied by Judge Edelstein, in an opinion reported at 149 F. Supp. 634, and this appeal followed. We think the decision and reasoning of the District Court were correct.

Appellant relies on two cases in particular to support his position. In *Martin* v. *Chandis Securities Co.*, 9 Cir., 128 F. 2d 731, the court affirmed an order of the court below quashing a previous order compelling testimony, on the ground that the testimony was "unnecessary" because the application for the initial order showed on its face that the claim was barred by limitations. The Government contended in that case that since a claim based on fraud would not be barred, further investigation was not "unnec-

[2] No taxpayer shall be subjected to unnecessary examinations or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the Secretary or his delegate, after investigation, notifies the taxpayer in writing that an additional inspection is necessary.

essary." The parties agreed that the Government was obliged to allege only reasonable grounds for suspicion of fraud, and the court expressly refrained from expressing an opinion on what the Government must allege. The holding was that the Government had not shown such grounds.

In *In re Brooklyn Pawnbrokers, Inc.*, E. D. N. Y., 39 F. Supp. 304, Judge Moscowitz held that, where the Government is investigating a claim barred by limitations in the absence of fraud, a general allegation of fraud is insufficient, that the Government is required to set forth facts affording reasonable basis for a suspicion of fraud. The holding was that "to permit the Government to examine as to statute barred years upon a mere conclusory allegation of fraud is to deprive the taxpayer of that freedom from unreasonable harassment that he has a right to expect under a democratic government."

There are cases going the other way. In *In re Keegan*, S. D. N. Y., 18 F. Supp. 746, the person summoned likewise objected that the statute of limitations had run. The Government said merely that it wished to investigate the possibility of fraud, to which it was replied that this was a "fishing expedition." Judge Patterson refused to vacate the order requiring obedience to the summons, saying, "Of course it is a fishing expedition, but it is none the less an examination which the revenue officers are entitled to make. I take it that whenever the officers charged with gathering in income tax decide to make a check to see whether a taxpayer has paid the full amounts due, they are doing no more than their duty when they summon persons with whom the taxpayer may have had dealings of a financial nature to reveal those dealings * * *."

In another case in which the investigation was said to be "unnecessary" because of the statute of limitations, *Peoples Deposit Bank & Trust Co.* v. *United States*, 6 Cir.,

212 F. 2d 86, cert. denied 348 U. S. 838, "a special agent of the Bureau of Internal Revenue testified in substance, that from his investigation he had concluded that there was strong suspicion of a false or fraudulent tax return by E. F. Prichard, Sr., for a certain year or years prior to the statutory limitation." The court held that "The special agent was not obliged to disclose in detail the facts relative to his investigation and conclusion, nor was the District Court obliged to require proof of facts showing reasonable grounds to believe that the tax returns of E. F. Prichard, Sr., and others were false or fraudulent." This decision was followed in *In re Wood*, W. D. Ky., 123 F. Supp. 297, 130 F. Supp. 121.

Several cases have held investigations not to be "unnecessary," although it does not appear that facts were alleged which indicated probable cause for the investigation. *Norda Essential Oil and Chemical Co.* v. *United States*, 2 Cir., 230 F. 2d 764, cert. denied 351 U. S. 964; *Globe Construction Co.* v. *Humphrey*, 5 Cir., 229 F. 2d 148; *Falsone* v. *United States*, 5 Cir., 205 F. 2d 734, cert. denied 346 U. S. 864; *United States* v. *United Distillers Products Corp.*, 2 Cir., 156 F. 2d 872. In *Matter of Levine*, 2 Cir., 243 F. 2d 175, affirming an opinion below, 149 F. Supp. 642, we adopted Judge Kaufman's statement that the Code "requires no showing by petition or affidavit that there is cause for believing taxes have not been properly paid where the examination is of the taxpayer himself as is the case here. The very purpose of the examination is to discover whether tax liability exists, and the provision was put into the law to enable the Treasury Department to perform its statutory duty of ensuring that taxes are being properly paid * * *. The question of probable cause for such investigations comes into play when a third party is requested to produce records relating to the taxpayer under investigation." The

opinion goes on to say that the petitioner has pointed out no procedural defect, "Nor does he invoke any question of the Statute of Limitations. Thus he has presented no reason for denying the Treasury Department its statutory right to examine him to see if taxes have been properly paid."

In analogous situations the Supreme Court has held that the Administrator need not establish coverage prior to investigating possible liability. *Okla. Press Pub. Co.* v. *Walling*, 327 U. S. 186; *Endicott Johnson Corp.* v. *Perkins*, 317 U. S. 501. Although those cases arose in different contexts, we think them applicable here. The taxpayer may not compel the Internal Revenue Service to defer its investigation until it has litigated the residence issue. It is not unlikely that a victory for the Service in such a contest might turn out to be an empty one, due to the running of the statute of limitations or the disappearance of leads to the extent of liability. The taxpayer is not entitled to sidetrack the investigation while the trail grows cold. The stricture against "unnecessary" examinations was designed to prevent uselessly repetitive procedures and investigations not relevant to possible tax liability, not to nullify the preceding sections of the Code.

We are not now called upon to resolve the apparent conflict between the cases dealing with what the tax authorities must show to warrant examination of the taxpayer and others relative to matters which may be barred by the statute of limitations. But we do hold that in such situations as the one before us now the Internal Revenue Service need not introduce evidence on the residence issue as a prerequisite to investigation. Were we to hold otherwise we would permit the taxpayer to control the course of the investigation and deprive the Government of the legitimate and wholly desirable advantage, which may well

prove decisive in particular cases, of pursuing *pari passu* the issues relating to earnings and income on the one hand and to residence abroad on the other. No one can tell until after the event, and the examination of the taxpayer has been concluded, what may or may not be the interrelation between these seemingly separate and distinct matters. Indeed, although the kind of legal work which petitioner did during these years, for whom, how much and on what basis he was paid, how he was paid and when, may all seem to bear largely on the amount of his income, it cannot be said that such information regarding the activities of a professional man are irrelevant to the question of his residence.

Affirmed.

*Appendix.*

## Judgment of the United States Court of Appeals

UNITED STATES COURT OF APPEALS

for the

SECOND CIRCUIT

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At a stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 8th day of July one thousand nine hundred and fifty-seven.

Present:

Hon. HAROLD R. MEDINA,
Hon. J. EDWARD LUMBARD,
Hon. STERRY R. WATERMAN,
Circuit Judges

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In the Matter of the Application of

EARL J. CARROLL,

Appellant.

UNITED STATES,

Appellee.

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Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is affirmed.

A. DANIEL FUSARO,
Clerk.